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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1932.

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# No. 112

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THE FEDERAL LAND BANK OF COLUMBIA,
A CORPORATION, PETITIONER,

*vs.*

MRS. WILL GAINES, RESPONDENT.

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## PETITION FOR WRIT OF CERTIORARI.

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*May it please the Court:*

The petition of The Federal Land Bank of Columbia respectfully shows to this Honorable Court:

Petitioner, hereinafter referred to as the bank, is one of twelve Federal land banks, chartered by the Federal Farm Loan Board pursuant to the provisions of the Federal Farm Loan Act (12 U. S. C. Ch. 7), and operating under the provisions of said act. This bank is authorized to and does lend money on the security of

qualified first mortgages on farm lands situated in the States of North Carolina, South Carolina, Georgia, and Florida.

On November 5, 1930, the respondent, hereinafter referred to as the borrower, executed and delivered to the bank her promissory note in the amount of $1,000, secured by a duly qualified first mortgage on certain farm property owned by her in the State of North Carolina.

This case involves the validity of the borrower's note and mortgage, which has been challenged on the ground of lack of consideration.

The facts of the case are set forth in an agreed statement at pages two to four of the record. Briefly, the facts are as follows: The borrower applied to the bank for a loan, making application through a national farm loan association chartered, organized, and doing business under the terms of the Federal Farm Loan Act. The application was granted by the bank upon the favorable recommendation of the association. The mortgage and promissory note were executed by the borrower in favor of the bank, were indorsed by the national farm loan association through which the borrower's application had been made, and the mortgage was recorded as a first lien against her land. The bank drew its check for the net proceeds of the loan, payable to the joint order of the borrower and the secretary-treasurer of the association. The secretary-treasurer deposited the check in a commercial bank to the association's account, having first obtained authority from the borrower to indorse her name thereon for the purpose of collecting the funds and disbursing them. A

small amount of the proceeds of the check was disbursed by the secretary-treasurer for the borrower's account in payment of taxes on her farm; and the balance was impounded in the commercial bank upon the closing of that institution three days after the deposit was made.

The Supreme Court of North Carolina sustained the contention of the borrower that, in the circumstances above related, the borrower received no consideration for her note and mortgage, except the sum of $54.23, which was disbursed for her account in payment of a tax lien.

The questions involved in this case are the following:

1. Whether consideration for the note and mortgage had passed from the Federal land bank upon payment of the bank's check for the amount of the loan evidenced and secured thereby, such check having been duly indorsed by the payees who were respectively the maker and indorser of the mortgage note.

2. Whether, under the Federal Farm Loan Act, a national farm loan association is the agent of the Federal land bank for the transmission of the proceeds of a loan to the borrower.

3. Whether a national farm loan association, in receiving and handling sums transmitted by a Federal land bank in connection with the closing of a mortgage loan, receives and handles such sums for the account of the borrower or as a "public agent."

4. Whether a mortgage executed and delivered to a Federal land bank is impaired or invalidated due to the loss of the sums transmitted

in consideration of such mortgage, while such sums are in the hands of the indorsing national farm loan association, which has receipted for the same.

The questions above outlined involve an interpretation of the provisions of the Federal Farm Loan Act respecting loans made by Federal land banks through national farm loan associations. These questions have never been submitted to or passed upon by this Court.

The ruling of the Supreme Court of North Carolina with respect to the issues of law in this case is contrary to a proper construction of the Federal Farm Loan Act and to the decisions of the highest courts of States other than North Carolina that have passed upon the question. For the reasons outlined below, the decision of these questions is of fundamental importance to the petitioning bank and to eleven other Federal land banks, which are organized and operated under the same Federal statute, and which serve all States of the Union by lending money on farm mortgage security in the States of their respective districts.

From the time of their organization in 1917 until March 4, 1933, the Federal land banks were restricted by law from making loans in the continental United States except (1) through, and upon the indorsement of, national farm loan associations and (2) through, and upon the indorsement of, duly qualified agents. With the exception of a comparatively small number of loans made in the early days of the system by the Federal Land Bank of St. Paul, all loans of the Federal

land banks have, up to the present time, been made through national farm loan associations. The total volume of such loans from organization to December 31, 1932, as reflected by the sixteenth annual report of the Federal Farm Loan Board, was 530,291, aggregating $1,723,495,414.87, of which the petitioning bank has made a total of 39,977 loans, aggregating $90,175,815.00. The number of associations involved in the closing of these loans was, for the entire United States, 4,979, of which 4,649 remain in existence; 501 of the existing associations being located in the States served by the petitioning bank.

These national farm loan associations are cooperative credit corporations, chartered by the Federal Farm Loan Board under the provisions of the Federal Farm Loan Act, and operating under the supervision and regulation of the Board.* Each association is authorized to do business within a limited territory, and its membership is restricted, under the act, to farmers who are borrowers from the Federal land bank of its district. The procedure involved in making a loan "through a national farm loan association" is prescribed by the Act. Under this procedure, a farmer applies for membership in the association, and for a loan upon the indorsement of the association. The as-

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*For the purpose of this petition, it appears unnecessary to refer to the abolition of the Federal Farm Loan Board, and the transfer of its functions to the Farm Credit Administration, by the Executive Order of March 27, 1933, effective May 27, 1933.

sociation then investigates the character and solvency of the applicant, and the value of his land which is tendered as security, and makes or refuses to make a favorable recommendation to the bank respecting the granting of the loan. Without the association's favorable recommendation, the bank may not make a loan to the applicant.

The Act requires that the farmer-borrower who obtains a loan from a Federal land bank through a national farm loan association shall purchase stock in the association in the amount of five per cent of his loan, and as a stockholder shall become individually responsible for all contracts, debts, and engagements of his association to the extent of the amount of stock owned by him at the par value thereof, in addition to the amount paid in and represented by his shares. The association in turn subscribes to an equal amount of stock in the Federal land bank and becomes liable for the loan by indorsement. The borrower's stock is held by the association as collateral, and the association's stock in the Federal land bank is held by the bank as collateral.

Among the provisions respecting the functions and powers of a national farm loan association, Section 11 of the Federal Farm Loan Act (12 U. S. C. 761) contains the following:

> "To receive from the Federal land bank of its district funds advanced by said land bank, and to deliver said funds to its shareholders on receipt of first mortgages qualified under Section 12 of this Act."

Under the provisions of Section 7 of the Federal Farm Loan Act (12 U. S. C. 714), it is the duty of the secretary-treasurer of a national farm loan association "to act as custodian of its funds and to deposit the same in such bank as the board of directors may designate, *to pay over to borrowers all sums received for their account from the Federal land bank upon first mortgage as in this Act prescribed,* and to meet all other obligations of the association subject to the orders of the board of directors and in accordance with the by-laws of the association." (Italics ours.)

Under a proper construction of these and other provisions of the Federal Farm Loan Act, the association is the agent of the borrower, acting for him in receiving for his account sums which are transmitted to it by the Federal land bank. The Supreme Court of North Carolina has held, however, that the association is not the agent of the borrower, but is a public agent, designated by the Act as an intermediary between the borrower and the bank; that the bank is required by the Act to transmit all funds for closing loans to the association; and that the bank has not fulfilled its obligation under the loan contract by delivering the loan proceeds to this "intermediary."

Even though the Supreme Court of North Carolina be correct in holding that the association is a statutory "intermediary," and is not acting as agent of the borrower, it appears that the Court has failed to apply the following general rule of law: Where two obligors have agreed that the consideration for their undertaking should be paid to one of such obligors, to be disbursed by the latter in accordance with the conditions

of the entire contract, consideration for the obligation has passed upon delivery of the same to the designated obligor. Under the provisions of the Federal Farm Loan Act, the national farm loan association is a co-obligor in connection with all loans made to its members by a Federal land bank. In other words, each loan made through an association constitutes a three-party contract: Between the bank (a Federal corporation) on the one hand, and the borrower, together with the association (a Federal corporation) on the other hand. This interpretation of the relationship between the three parties to a loan contract, made pursuant to the provisions of the Federal Farm Loan Act, has been sustained by the courts in the following cases:

*Bjorkstam* v. *The Federal Land Bank of Spokane*, 244 Pac. 981, 136 Wash. 446;

*Holvick* v. *Black*, 221 N. W. 71, 57 N. D. 270;

*Whitaker* v. *Fulton*, 17 S. W. (2d) 1079 (Tex. Civ. App.);

*The Federal Land Bank of St. Paul* v. *Byrne*, 237 N. W. 797 (N. D., 1931);

*The Federal Land Bank of Omaha* v. *Omaha National Bank of Omaha*, 225 N. W. 471, 118 Nebr. 489;

*The Federal Land Bank of Columbia* v. *Shingler, et al.*, 174 Ga. 352, 162 S. E. 815.

The petitioning bank avers that the Supreme Court of North Carolina erred in deciding that no consideration had passed for the note and mortgage in suit; and if this petition be granted, petitioner will develop the following points: (1) that the court should have

applied to the case the ordinary rule that consideration passed upon the payment of the check transmitted by the lending bank, following the indorsement of that check with the borrower's name by one authorized to do so; (2) that there is nothing in the Federal Farm Loan Act which, as the court appeared to think, precludes the application of the rule just stated, in the case of a check drawn by a Federal land bank to the order of a borrower and an indorsing national farm loan association; and (3) that even if the borrower had not been designated co-payee of the check transmitted by the bank, delivery of the loan proceeds to the indorsing national farm loan association would have constituted complete fulfillment of the bank's obligation under the loan contract, both by reason of the provisions of the Federal Farm Loan Act and under the general rules of law.

The interpretation of the questions involved in the instant case is of particular importance to the petitioning bank and to all Federal land banks at the present time for the reason that the Emergency Farm Mortgage Act of (May 12) 1933, contemplates the immediate expansion of the activities of these banks to the extent of $2,000,000,000 in additional farm mortgage financing operations.

The funds to be used by the banks in this tremendous program of refinancing the nation's farm mortgage debt are to be obtained, under the new law, by the issuance of bonds which are to be fully and unconditionally guaranteed as to interest payment by the Government of the United States.

It is provided that, except in areas where the banks find it necessary to make direct loans pursuant to the limited authority granted under the Emergency Farm Mortgage Act of 1933, these refinancing operations will be accomplished by means of refunding loans made through and indorsed by national farm loan associations.

In order that the banks may issue bonds and obtain funds for the purpose of refinancing farm mortgages, it is essential that the banks deposit eligible collateral security, at least equal in amount to the new bonds. This collateral must, as a practical matter, consist of qualified first mortgages on farm lands. It will be impossible for the banks to proceed with the program which Congress has outlined unless they are able to make the necessary collateral deposits.

Under the rule stated by the Supreme Court of North Carolina, a bank would have to deliver to the association the consideration for each refunding loan made through a national farm loan association. The association, though organized, operated, and controlled by borrowers for their mutual benefit, would be deemed a "public agent, designated by the Act as the intermediary between the bank and the borrower." Under the North Carolina Court's decision, the bank would deliver the loan funds to the association, but such delivery would not constitute consideration for the mortgage until the last dollar of the funds had been disbursed by the association. Even if the bank should designate the borrower as co-payee of a check representing loan funds, such designation would be regarded,

as in the instant case, as mere surplusage. Therefore, it would be necessary for the bank to utilize the services of a "public agent" not responsible to it and over which it had no control.

Therefore, in order that the petitioning bank and the other eleven Federal land banks may be in position effectually to operate their greatly enlarged program of farm mortgage operations which is contemplated in the new legislation above referred to, it is essential that the relations between such banks and the several associations of their districts be clearly defined.

For the convenience of the Court, this petition is accompanied by supply of a document issued by the Federal Farm Loan Board known as "Circular No. 20," which contains the Federal Farm Loan Act as amended to July 16, 1932. An amendment to the Act, approved March 4, 1933, has been slipped into this circular, immediately behind the cover sheet. In order that the Court may have before it in convenient form copies of the Emergency Farm Mortgage Act of (May 12) 1933, petitioner is also furnishing a supply of Public Law No. 10, Seventy-third Congress, Title II of which has been designated as "The Emergency Farm Mortgage Act of 1933."

WHEREFORE, petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the Supreme Court of North Carolina, commanding that court to certify and to send to this Court for its review and determination, on a day certain, to be therein named, a full and complete transcript of the record and all proceedings

in the case, numbered and entitled on its docket No. 552, *Federal Land Bank of Columbia, South Carolina*, Plaintiff, v. *Mrs. Will Gaines*, Defendant, and that the said judgment of the Supreme Court of North Carolina may be reviewed by this Honorable Court, and that petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just.

THE FEDERAL LAND BANK
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